SPEECHES & TESTIMONY

Opening Statement of Commissioner Brian Quintenz before the CFTC Market Risk Advisory Committee Meeting

July 12, 2018

Thank you Commissioner Behnam for convening today's meeting of the Market Risk Advisory Committee (MRAC). I am delighted to join you and Chairman Giancarlo, and all of the new and returning members of this Committee, for the first meeting of the MRAC under its renewed charter. I look forward to hearing from MRAC members about the priorities and initiatives they wish to address during their two-year term.

I am also pleased that today's meeting is devoted to addressing the reform of London Interbank Offered Rates, otherwise known as LIBOR. This is a timely matter and one that has a wide-ranging effect on the derivatives markets. I support the ongoing benchmark reform initiatives and the development of alternative risk-free rates (RFRs), in particular the efforts of the Alternative Reference Rate Committee (ARRC) to establish the Secured Overnight Financing Rate (SOFR) as a new benchmark rate for U.S. dollar-based business. It is essential to the vitality and stability of the global derivatives market that participants trust the integrity of global financial benchmarks.

I would like to take a moment to commend the Division of Enforcement's aggressive prosecution of those who sought to manipulate LIBOR and other benchmarks that are critical to the functioning of our financial markets. Those who seek to subvert the accuracy of these benchmarks for their own financial gain should be held accountable, and I support the Commission's relentless efforts to pursue bad actors and restore public confidence in the integrity of these benchmarks.

Over $300 trillion of financial products, ranging from interest rate derivatives to home mortgages, are tied to LIBOR or other interbank offered rates.[1] It is therefore critical that these reference rates reflect an honest assessment of the costs of borrowing unsecured funds in the interbank markets. Since 2013, banks have worked to improve the governance surrounding their LIBOR submissions so that the rate is more closely tied to transactions rather than subjective judgements.[2] However, given the decline in activity in the unsecured bank funding market, and the absence of an FCA mandate for LIBOR submissions post-2021, firms should seriously consider the long-term sustainability of solely relying on LIBOR. Although LIBOR may continue to exist into the future, if participation continues to decline, questions may arise as to whether the rate continues to accurately reflect market conditions. The development of alternative RFRs that are based on actual transactional data from robust, underlying markets will provide a transparent, viable alternative to LIBOR for market participants.

I appreciate the hard work of the ARRC to develop a market-based alternative, SOFR, which represents the cost of borrowing money secured by Treasury securities overnight. I think it is incumbent upon the the Commission, our international counterparts, and the markets themselves to carefully consider how the widespread adoption of SOFR and other RFRs could be accomplished in a manner that avoids unnecessary confusion, fragmentation, and disruption.

The introduction of RFRs poses a number of significant challenges for the derivatives markets. For starters, the markets must develop a forward-looking term structure for overnight rates like SOFR. New cash and derivative products referencing alternative RFRs must be created and robust markets for those products must be cultivated, so that market participants continue to have access to liquid, efficient trading. On that front, the launch of SOFR futures this past May is a first step toward creating a market for such products; additionally, these futures contracts may be useful as the markets build a forward-looking term structure.

For market participants transitioning to RFRs, much work lies ahead. Each firm must develop its own individual implementation plan, including assessing its exposures tied to LIBOR-based products and determining how to amend legacy contracts to reflect an alternative RFR. Risk management models must be updated to incorporate RFRs and take into account the basis risk that will exist between LIBOR and the various RFRs across jurisdictions during any transition period. I would also encourage all firms to understand the fallback language that would govern their contracts in the event that LIBOR, at some point in the future, is no longer used.

For its part, the Commission can provide market participants with regulatory certainty regarding the treatment of legacy LIBOR-based contracts that are amended to reference new RFRs – including how margin, trading, and clearing requirements would apply to such amended contracts.

I would also like to note something we are not addressing today: the European Union (E.U.) Benchmarks Regulation, which took effect this past January and sets forth a comprehensive regulatory regime for benchmarks administrators.[3] Proposed amendments to this regulation could impact U.S. firms.[4] These amendments could result in yet another example of extraterritorial overreach by E.U. authorities, analogous to the proposed amendments to the European Markets Infrastructure Regulation (EMIR) regarding the regulation of third-country CCPs.[5]

The U.S. has not issued regulations analogous to the E.U. Benchmarks Regulation. Instead, U.S. regulators have encouraged U.S. benchmarks administrators to abide by the Principles for Financial Benchmarks published by the International Organization of Securities Commissions (IOSCO) in 2013.[6] Given the cross-border implications of the E.U.'s proposed amendments, I hope that U.S. regulators and their counterparts can coordinate on this issue so that benchmark administrators do not become subject to conflicting requirements across jurisdictions and that regulatory deference is respected.

In closing, I am eager to hear from the presenters on our panels today and MRAC members about how benchmark reform can be supported and what additional steps the Commission can take to foster the development of active derivatives markets referencing RFRs. I look forward to the robust two-year agenda that this Committee will develop today, and I thank Commissioner Behnam and his staff for their hard work in planning today's meeting.

[1] ISDA, IBOR Global Benchmark Transition Report (June 2018), http://assets.isda.org/media/85260f13-66/406780f5-pdf/ (http://assets.isda.org/media/85260f13-66/406780f5-pdf/).

[2] Remarks by Andrew Bailey, Chief Executive of the FCA, The Future of LIBOR (July, 27, 2017), https://www.fca.org.uk/news/speeches/the-future-of-libor (https://www.fca.org.uk/news/speeches/the-future-of-libor).

[3] Benchmarks, European Securities and Markets Authority, https://www.esma.europa.eu/policy-rules/benchmarks (https://www.esma.europa.eu/policy-rules/benchmarks).

[4] Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 2016 / 1011 on indices used as benchmarks in financial instruments (Benchmarks Regulation), Article 8 (Sept. 20, 2017), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017PC0536&from=EN. *See also* Huw Jones, *EU Lawyers Back More Say for Bloc's Watchdog over Funds Industry,* Reuters, June 26, 2018, https://www.reuters.com/article/us-eu-regulation-legal/eu-lawyers-back-more-say-for-blocs-watchdog-over-funds-industry-idUSKBN1JM261 (https://www.reuters.com/article/us-eu-regulation-legal/eu-lawyers-back-more-say-for-blocs-watchdog-over-funds-industry-idUSKBN1JM261).

[5] Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (ESMA) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorization of CCPs and requirements for the recognition of third-country CCPs, COM (2017) 331 final (June 13, 2017), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017PC0331&from=EN.

[6] IOSCO Principles for Financial Benchmarks, https://www.iosco.org/news/pdf/IOSCONEWS289.pdf.